How the Fed Played Us—And Cornered Themselves as Recession Signs Mount

written by Matthew Piepenburg | November 11, 2021

With the *possible* exceptions of Bill Martin and Paul Volker, history will one day confirm that the Fed is precisely what Thomas Jefferson warned: A parasitical banker's-bank that will do more damage within its host nation than a foreign army standing on its shores. Here's the story of how the Fed played us.

The Fed's more recent history of just plain dishonesty, manipulation and market favoritism at the expense of economic realism and free market price discovery opened with **patient-zero Greenspan** and then remained embarrassingly consistent via the identical policies of **Bernanke**, **Yellen** and **Powell**.

For years, *we have shown this with data rather than drama*.

The latest and most obvious evidence of form over substance and words over truths from the Eccles Building is the Fed's desperate **inflation narrative** as well as **inflation conundrum,** which boils down to this:

If the Fed doesn't tackle the real rather than "transitory" inflation problem (i.e., by raising rates), the bond market tanks; however, if the Fed tries to raise rates to save bonds, it kills the stock market.

This, of course, *is* a conundrum, forcing the Fed, as one commentator observed, "to ride two horses with the same a$$."

Ultimately, however, we all kind of know how that can end…

Two Sides of the Same Mouth

But as we discover below, the Fed’s solution to this conundrum is to do what the Fed does best: Spin, obfuscate and fib.

This means talking hawkish yet remaining dovish when it comes to keeping the liquidity spigot fully open to an otherwise fully-Fed-dependent equity and credit market.

Or in plain speak, this means publicly “tapering” the QE money printing with *words* while replacing that liquidity with hidden but otherwise consistent *acts* of alternative liquidity from, *inter alia*, the Standing Repo Facility (SRF) and FIMA swap lines.

Ackman’s Mistaken Battle Cry

Recently, hedge fund manager **Bill Ackman** made a presentation to the New York Fed recommending an immediate and *meaningful* taper along with equally *meaningful* rate hikes.

Needless to say, the equally recent and much-headlined (though hardly *meaningful*) Fed “tapering” from $120B/month to $105B/month was an open farce, just as a Fed balance sheet rocketing toward $9T hardly suggests that our securities markets can ride on their own without central bank training wheels.

After all, a bottle of whiskey a day is hardly less of an addiction than a bottle and glass a day of whiskey…

Such ongoing rather than "tapered" accommodation hardly suggests that our market is anything but a broken vehicle surviving exclusively on the artificial support of (and addiction to) a deadly monetary experiment in which trillions of currency-debasing and inflation-generating dollars are produced with a mouse-click with each passing (and compounding) month.

Clearly, Ackman, like so many Wall Street dragon-slayers, is worried about cancerous inflation, as it makes a mockery of bonds whose yields can't outpace inflation's cruel bite—hence his valiant call for a rate hike, the 85% chance of which has already been priced into the market.

But Mr. Ackman, like Mr. Market, is forgetting a few, well…risks and realities in his otherwise forceful presentation: Namely, *the Fed can't afford to raise interest rates* *above* *inflation rates*.

Damned If They Do, Damned If They Don't…

Yes, inflation is a major risk normally worthy of a rate reaction/hike, but unfortunately, there's **nothing normal** at all about the current debt reality.

Central bankers have put us and themselves into a fatal corner regarding rate hikes that boils down to: "Damned if they do, damned if they don't."

Like so many spoiled hedge fund managers and retail investors who came of age in a world where money was effectively free for a select few, Ackman has gotten used to fiscal fantasy to the point where it's part of his financial sub-conscious.

In this way, he's forgotten one sad but simple fact: We can't raise interest rates higher than inflation rates.

Why?

Because as a debt-soaked nation as well as debt-driven market, we are too broke to pay the rate piper unless we do so with inflated (i.e., debased currencies).

Thus, *the Fed can pretend to worry about inflation while it simultaneously and* *deliberately* *seeks more of it*.

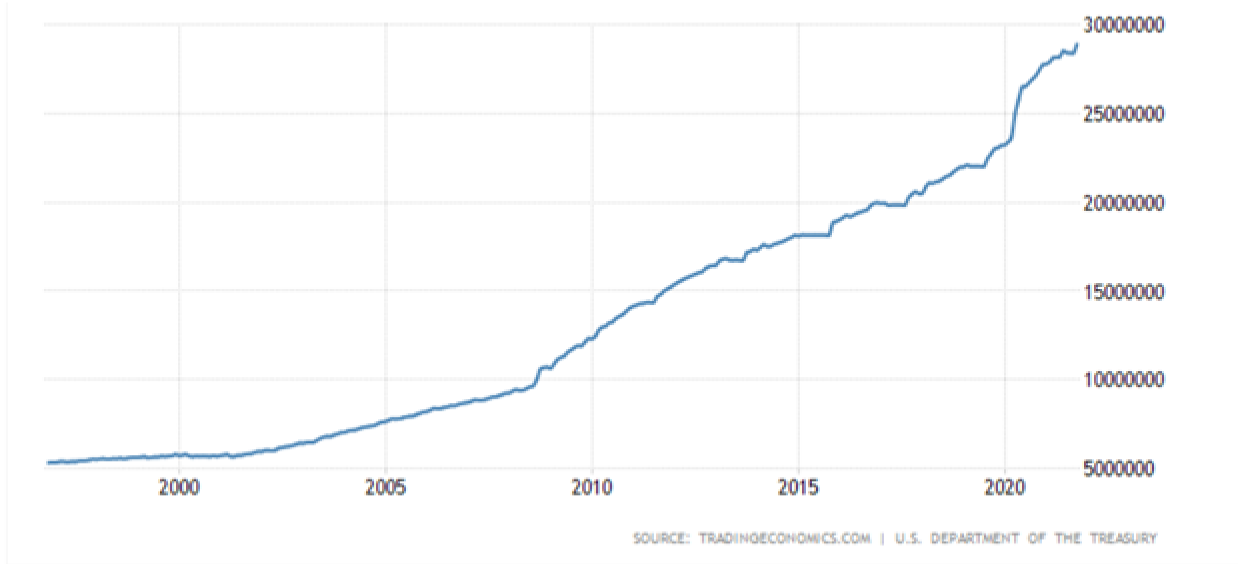
As I've said elsewhere, **negative real rates** are the *only* option going forward.

The shameful debt pyre/pile that has grown along with Ackman's net worth in the preceding decades makes a rate hike less of an option than it is a bullet to the heart of an artificial market.

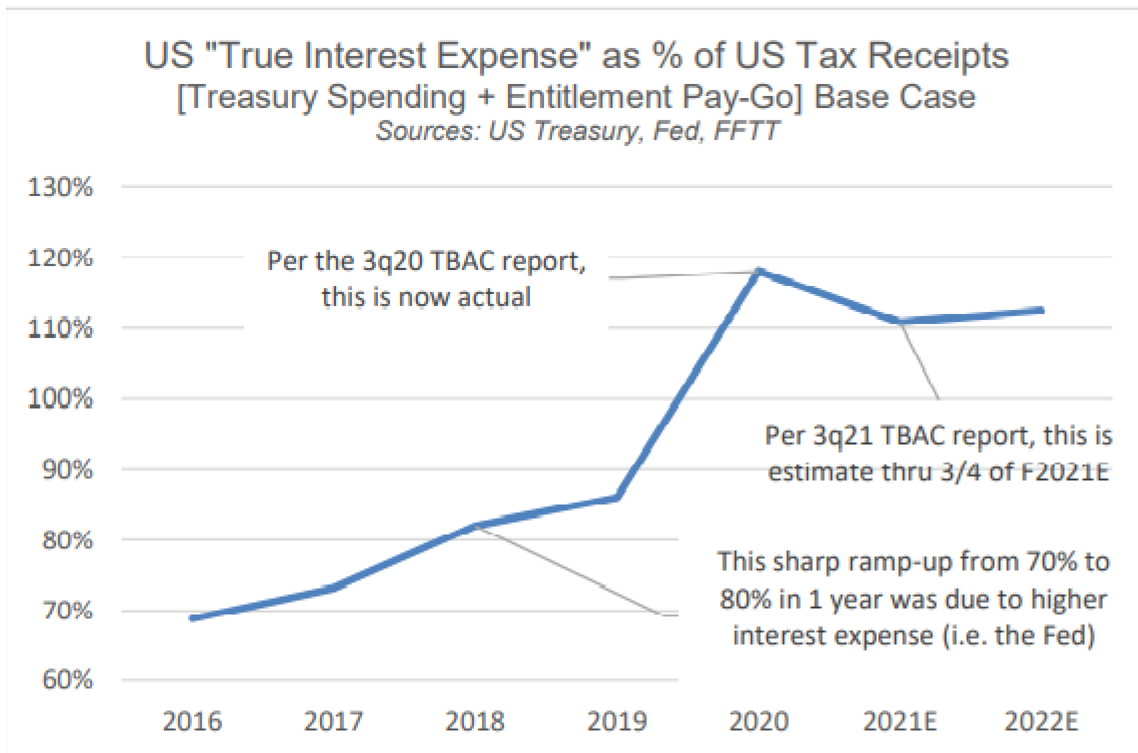
In other words, the reality of our debt pile makes inflation (and more rather than less liquidity) far more necessary than the experts would want us to otherwise believe.

I would remind Mr. Ackman, for example, that even **Uncle Sam has to pay interest on his debt**—and it's at an embarrassing as well unprecedented (not

to mention unsustainable) level.



Specifically, Ackman and others need to remember that even at the 5000-year, all-time low-rate fantasy environment in which the Fed has placed us, there was and is not enough tax revenues coming in to pay even the *interest expense alone* on the insane debt levels currently owed.



Forcing rates higher, as Ackman recommends, would only make those interest expenses even more comically unpayable than they *already* are.

Thus, any public taper (i.e., removal of printed/QE liquidity) and rate hike would need to be (and will be) immediately offset with new liquidity in the form of FIMA swap lines, the SRF and new SLR exemptions allowing **toxic banks** to employ more rather than less deadly leverage.

In short, and notwithstanding “taper” tough-guy talk from the Eccles

Building, the needed, as well as inflationary and currency-debasing liquidity, will come from somewhere.

If not, the VIX and USD will shoot to the moon and stocks will sell toward the basement.

But here's the rub…

If the Fed won't deal with inflation via a literal rather than figurative elimination of liquidity, stocks will continue to rise but bonds will spiral as liquidity-driven inflation eats away at their already *negative* yields.

See what I mean by damned if they do, damned if they don't?

Doves and Hawks—Squawking in Tandem as the Fake-It Policies Continue

A dovish Fed is thus good for stocks but bad for bonds. A hawkish Fed is good for bonds but bad for stocks.

See the dilemma?

So, what can we expect?

Simple: More faking it and more *QE-like* liquidity under a different name, specifically, more repo support gone wild, more FIMA swaps and more "permitted" leverage by those very dangerous banks under the Fed's protection.

The Fed has so thoroughly, negligently, recklessly and stupidly put us and the rest of the world into an insane quandary.

Not Your Ordinary Bond Market—In Fact No Market at All

The grotesquely supported and openly artificial US sovereign bond market (i.e., Treasury market) is not just any bond market.

It's the largest and most important bond market in the world.

Its published rate acts as the risk-free (yet return-free…) rate for all the additional assets under the Capital Asset Pricing Model (CAPM).

In short, the US Treasury market matters, and the Fed will use the back channels above to "prop" it.

Unfortunately, however, and apparently still unknown to most, is that this bond market is **no market at all.**

Instead, the Fed simply creates money out of thin air and acts as permanent bidder on U.S. IOU's that no one wants to buy but the Fed itself.

Since February of last year, greater than 55% of Uncle Sam's IOUs (i.e., Treasury bonds) were bought by the Fed itself.

More bluntly: The US Treasury "market" is like a **lemonade stand in the Alaskan tundra** where the only buyers of its unwanted beverage are its owners, who use counterfeit money printed in an igloo to maintain a robust "sales report."

As a recent Bloomberg op-ed reminded us, the U.S. Treasury market is "a political construct where the Fed dominates trades and sets rates at whatever politically-expedient levels the U.S. government or Fed require."

Or stated even more simply: The Fed played us, and the U.S. Treasury market is an open sham.

Greasy Tricks, Greasy Sleeves

The Fed can use other liquidity tricks up its greasy, tattered and discredited sleeves to always keep U.S. Treasuries "bought" despite tanking demand for these unloved IOUs.

In addition to the repo pits, swap lines and loosening bank rules, it can even impose yield caps and inevitable yield curve controls.

But in the end, the Fed will do what it always does: Lie, rig and false virtue signal its "war" on inflation.

"It's Good to be the King"

And by that, I am simply saying the Fed will continue to pour more liquidity (i.e., more fiat/fake money) into the UST market via SRF and other means (i.e., increased short-term bond issuance for money markets) to keep stock markets "accommodated' while publicly *appearing* to be hawkish by "signaling" a QE "taper" or rate hike to "fight" inflation, the actual levels of which it will **intentionally mis-report** (and down play).

Translated even more simply, *the Fed will publicly "fight" inflation while privately promoting it and then openly misreport it.*

As Mel Brooks might say: "It's Good to the King—or Fed."

Thus, as the Fed nominally "tapers," liquidity will just keep coming in the form of QE by other names.

Un-recovered Addicts

For this reason, we feel liquidity (the kind that kills currencies) will keep on coming, as the banks and markets are now fully addicted to the same.

This, of course, will be good for gold, BTC and stocks, all of which will fare much better than fixed income assets, which, let's be honest, are just *negative* income assets when adjusted for persistent rather than transitory inflation.

Meanwhile, the Fed *pretends* to tackle inflation but deep down seeks more of it in order to get the U.S. out of debt the old-fashioned way—by inflating

their way out of it.

Loading Up the Money Markets, Ignoring the Middle Class

The fact that the US Treasury Dept is slashing long-term debt issuance in favor of shorter-term debt for the first time in 5 years just as they were announcing a “taper” was no coincidence.

Instead, it is evidence enough that they are loading up the money markets as an alternative form of QE by another name.

Such pro-inflationary reality hiding behind a tough-on-inflation stance/facade, by the way, is great for markets and just criminal for the real economy and the middle class.

But nothing new there. The Fed is a banker’s-bank and a Wall Street backstop; it doesn’t give a hoot about the middle class.

What If…

If, however, and only if, the Fed actually and truly did cut liquidity (i.e., no back-end support via repo lines, swaps, and front-end curve/money market issuance to cover a “fake taper”), then just about every asset but the USD and VIX will suffer, including gold and silver.

That, however, is highly unlikely.

As we’ve written before: **Addicts are predictable**, and the Fed’s (as well market’s) addiction to liquidity won’t stop just because, as Ackman ironically believes, it ought to.

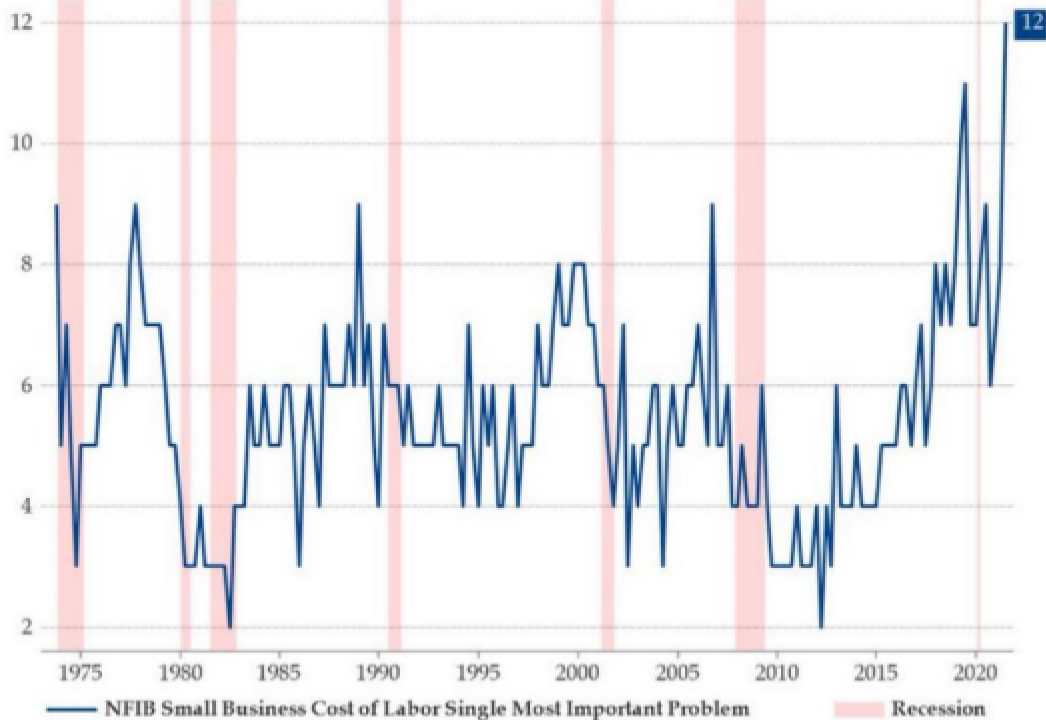
In short, prepare to see the liquidity run, the dollar loose even more of its inherent purchasing power and real stores of value like gold shine.

The Real Economy Isn’t Smiling, It’s Warning Us of a Recession

As for the markets, they may and will receive more “accommodation” from a Fed who cares little for the real economy, but that real economy still matters—and it’s sending dangerous warning signs.

Recently, for example, I noted that the **NFIB’s rating for small business conditions** in the U.S. had its 3rd lowest levels in 50 years.

Well, that same NFIB has also just reported that the cost of labor for those businesses is hitting a 48-year high.



The foregoing data (12-handel) is not only a screaming inflation indicator, but a time-tested recession indicator.

At levels of 8 and above, this late cycle barometer has *always* seen recessions follow within 19 months.

Gosh, facts are stubborn things, no?

In short, and regardless of what the Fed pretends, they can't print away, hike away or repress away an *economic* recession, which will likely be the bottom-up straw that ultimately breaks this artificial market's back.

Just saying…